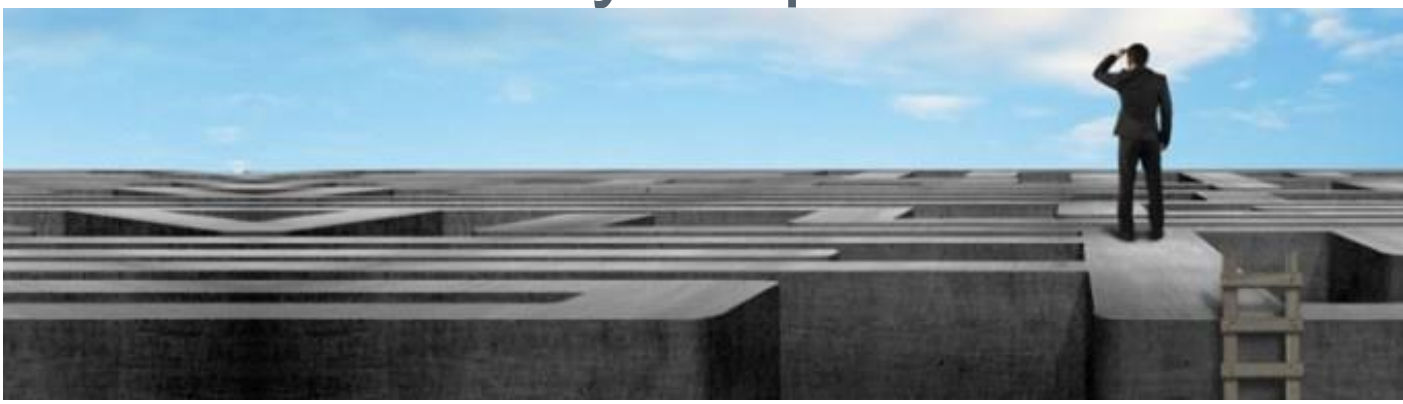
Mediation in International Insolvency Disputes



I. WHY MEDIATE INTERNATIONAL INSOLVENCY MATTERS

Successful negotiation is necessarily premised on trust and honest communication. Unsurprisingly however, trust between parties engaged in high-stakes commercial disputes is frequently in short supply. In American insolvency proceedings such distrust is compounded, as winding up proceedings are handled by the companies' directors themselves, and not an official receiver as is the practice in other jurisdictions. Judge Peck notes that during insolvency proceedings, parties may bear resentment against each other in relation to the decisions and circumstances that led to the need for litigation in the first place.

One of the primary objectives of mediation, Judge Peck states, is to restore communication channels between parties to mitigate against further deterioration in their relationship. Judge Peck notes that the involvement of the neutral mediator allows parties to explore settlement options without feeling as though their legal position has been compromised. This creates a safe and confidential communication channel between parties, allowing them to discover mutual interests and rebuild relationships. Whilst building trust can be a lengthy and laborious process, especially in insolvency proceedings which frequently involve numerous parties, this process opens up the possibility of settlement as trust and willingness to compromise would have been established.

II. CASE STUDIES

Judge Peck attributes the rise in the use of the mediation in insolvency disputes due to the changing face of insolvency practice itself. He notes that insolvencies have become much more complex due to the involvement of new stakeholders and players, particularly in the US. These range from traditional stakeholders such as directors, shareholders and unions, to new breeds of actors including hedge fund managers and investment bankers. The involvement of the latter players, who are usually well-funded, sophisticated and tenacious, has led to a sharp upswing in the willingness and ability of parties to litigate over disputed legal entitlements and valuations.

A. Lehman Brothers Holdings Inc.

While domestic insolvencies are complex in their own right, these issues really come to a head when insolvencies occur on the international stage, such as when the insolvency proceedings

involve high profile multinational corporations. This was the situation in the case of *Lehman Brothers Holdings Inc.,* No. 08-13555 (JMP) (Bankr. S.D.N.Y.) (hereinafter "Lehman"). In Lehman, the collapse of the financial institution and its affiliates resulted in 75 simultaneous legal proceedings in over 40 countries, dealing with the estates of the 18 major Lehman subsidiaries. Not only were these proceedings highly convoluted, many national courts dealt with the legal issues in question differently, resulting in varied and in some cases conflicting outcomes across the various jurisdictions.[1]

To ensure that the company could adequately settle their losses and net off profits from their derivative agreements, Lehman applied to the Bankruptcy Courts for leave to mediate with the approximately 250 counterparties. Of the 77 proceedings which reached the mediation stage, only 4 were terminated without settlement. This largely successful mediation process enabled Lehman to avoid commencing costly and time-consuming legal proceedings, thereby streamlining the judicial process and allowing Lehman to move ahead with the administration of its estate.

B. MF Global Holdings Ltd

Mediation was similarly successful in the international insolvency case of *In re MF Global Holdings Ltd*. No 11-150559 (MG) (Bankr. S.D.N.Y.). On 31 October 2011, MF Global and affiliates ("MF Global") filed for bankruptcy protection in New York, while its UK affiliates were placed in special administration in Wales and England. Each estate cross-claimed against one another, and all desired a "global resolution" of its claims. When in 2012 it became clear that parties were entrenched in their positions and that protracted litigation was becoming increasingly likely, the sitting bankruptcy judge informally encouraged mediation between the UK and US holdings. Mediation in this case was highly successful and produced the desired global settlement resulting in MF Global's creditors being able to receive over USD$1billion in aggregate distributions.

C. Nortel Networks Inc.

However, mediation, like all forms of dispute resolution, has its limits. This was evident in the case *of Nortel Networks Inc*. No: 09-10138 (Bankr.D. Del.) ("Nortel"). In this case, Nortel and its affiliates voluntarily petitioned for bankruptcy relief in the United States, Canadian, English and French Courts. Nortel's assets were aggregated and sold for approximately $7.5 billion. The estates of all the affiliates have since been unable to agree on the manner in which the proceeds of the sale are to be divided. Three rounds of mediation, both voluntary and court-ordered have failed, as parties have become extremely entrenched in their positions and have not been able to compromise on their percieved entitlements to ensure an equitable distribution of the assets. As a result, the parties were unable to come to a consensual arrangement for the allocation of Nortel's assets. To date, Nortel's thousands of creditors ranging from hedge fund managers to retirees have been embroiled in litigation and Nortel has paid over $1.3.billion in professional fees since its bankruptcy proceedings were filed.

III. ENSURING SUCCESSFUL OUTCOMES

Mediation has been said to be most effective if conducted as the appropriate window. It is not easy to discern when this opportune juncture is. However, as bankruptcy practitioners in the US become increasingly familiar with the process of mediation in complex insolvencies, judges and lawyers are becoming more adept at determining the window at which mediation will be most fruitful.

Judge Peck also stressed the need for the involvement of key decision makers in mediation proceedings. He observed that mediation proceedings involving parties who sent representatives that were not authorised to make critical decisions were unnecessarily prolonged or unsuccessful. Key decision makers who did not attend the mediation were more likely to question decisions and

shoot down settlement plans, as they would not have been part of the consensus-building process in the mediation chambers.

The most successful mediations are those in which there is a sincere desire to settle the dispute and where authorised representatives of all interested parties attend. Often, parties who are compelled by the Courts to mediate form the mindset that the mediation is doomed to failure and any revelation of the parties' position would only serve to weaken its case when the dispute goes to litigation. In situations like this, the effectiveness of mediation is limited and the likelihood of reaching a settlement is low; mediation is more likely to be successful when it is voluntary and initiated by the parties. However, Judge Peck notes that the skill and experience of the mediator is particularly relevant in court-annexed mediations, as an able mediator would be more likely to draw parties out of their respective corners and to the table to negotiate in good faith.

Judge Peck also highlighted the need for the Courts to facilitate the mediation proceedings, to ensure any and all plans drawn up have the force of law. Without adequate judicial support, parties to the mediation may experience difficulties enforcing arrangements which have been drawn up during the mediation. Such enforceability issues may pose particular concern when mediating complex cross-border insolvency disputes. To this end, Judge Peck notes that the most effective mediated arrangements would include a clause which allows parties to refer the agreement to the appropriate court if certain essential terms are not adhered to. However, given the voluntary nature of (most) mediations, these clauses are simply a manner in which to give the agreement "teeth" – and it is largely anticipated that parties will abide by the agreement without having to resort to another round of litigation.

IV. CONCLUSION AND COMMENTS

As an alternate dispute resolution mechanism, mediation has its limits and remains dependent on judicial support to ensure its enforceability. In relation to complex international insolvency matters, it may be important for parties to gain approval of the mediation process (from the appropriate national courts and insolvency authorities) before any material steps in the direction of mediation are undertaken. To allay concerns from creditors and other stakeholders who may view the mediation proceedings as a distraction, concrete timelines as to the mediation process should also be provided. The collaboration between the parties required to achieve such a framework would be an early test of the parties' commitment to mediation. Judicial endorsement of the mediation process would also go a long way in addressing concerns regarding the enforceability of any mediated settlement that ensues.

As the cases highlighted by Judge Peck illustrate, the field of international insolvency is ripe for intervention via mediation. The speed and flexibility of mediation makes it an ideal process for multinational companies who are seeking to avoid the costly and time consuming quagmire of transnational litigation. Particularly in the current global economic climate, it anticipated that the prominence of international mediation in cross-border insolvency cases is set to increase. It is possible that more alternate dispute resolution institutions may offer specialised rules and panels to administer the mediation of complex cross-border insolvency disputes. IAA

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